



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Release Number: **201145025**  
Release Date: 11/10/11  
Date: August 18, 2011  
UIL Code: 501.00-00  
501.03-30  
509.02-02

Contact Person:  
  
Identification Number:  
  
Contact Number:  
  
Employer Identification Number:  
  
Form Required To Be Filed:  
  
Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Sean M. Barnett for

Lois G. Lerner  
Director, Exempt Organizations

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: July 5, 2011

Contact Person:

Uniform Issue List Numbers:

Identification Number:

501.00-00

Contact Number:

501.03-30

FAX Number:

509.02-02

Employer Identification Number:

Legend:

State =

Hospital =

Partner PHO =

Insurance Company =

Date 1 =

Date 2 =

Dear

We have considered your application for recognition of exemption from Federal income tax under section 501(a) of the Internal Revenue Code (the "Code") as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. We have separately considered whether, for foundation classification purposes, you qualify as a supporting organization under section 509(a)(3) of the Code. Based on the information submitted, we have concluded that you do not qualify as a supporting organization under section 509(a)(3). The bases for our conclusions are set forth below.

Facts

You were formed on Date 1 as a non-profit corporation under the laws of State. You filed Form 1023 (Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code) on Date 2.

According to your Articles of Incorporation, the purpose for which you are organized "is the transaction of any and all lawful business for which non-profit corporations may be organized under the laws of [State] and for which corporations may be engaged including, without limitation"...

- (i) establishing or participating in one or more health care delivery networks, (ii) enhancing the delivery of care to the general public through the exchange of ideas, (iii) developing programs and procedures that enhance patient care, (iv)

encouraging efficiency and promoting high ethical standards, (v) educating the general public about cost effective medical services, (vi) providing a forum for communication about advancements in medicine and the delivery of health care services, (vii) providing an opportunity for the improvement of medical practice management, . . . .

### *Activities*

Your “primary activity ... is to establish and participate in a health delivery network.” You do not provide medical services directly, nor do you conduct activities that Hospital conducted prior to your creation or in which it would otherwise engage. Rather, you negotiate and enter into “Payor Agreements” with purchasers of physician medical services for subscribers of a benefit plan (e.g., health maintenance organizations, preferred provider organizations and arrangements, employers, insurance carriers, third-party employee benefit plan administrators, self-funded plans and groups, and similar organizations), and under which you are obligated to provide or arrange for the provision of such physician medical services. Concurrently, you enter into “Member Agreements” with physicians who are on the medical staff of Hospital and have unrestricted admitting and clinical privileges at Hospital or who are Hospital-based physicians, and who, by entering into such agreements, become “Participating Physicians.” Your sample “Approval of Membership” letter states, “Upon receipt of your signed agreement and assessment fee, you will become eligible to participate with the various insurance company contracts approved by [us]. You will then be provided with reimbursement information and forms necessary to participate for each contract available to [our] members.” You charge an annual membership fee of \$200 per physician, which Hospital matches. While the Participating Physician still owns his own medical practice, the physician agrees to see managed care patients according to the terms of the applicable “Payor Agreement.” You use a “messenger model” whereby you “act as a vehicle for communicating fee schedule offers to [Participating Physicians] and [Participating Physician’s] counteroffers to insurers.” You state that Participating Physicians have the freedom to refer patients to any provider of choice without any influence or inducement from you. You also state that you encourage Participating Physicians to provide charitable care, but you do not impose charity care requirements on the Participating Physicians.

Pursuant to your Member Agreement, you are required to use your best efforts to market and negotiate agreements with payers, which include provisions for the payers to pay either you or the Participating Physician for “covered services.” Covered services are defined in the Member Agreement as those which are medically necessary, are provided by participating physicians, are covered by the applicable benefits plan, and which you are required to provide to or arrange for members pursuant to the applicable payer agreement.

Also under the Member Agreement, you are obligated to pay the Participating Physician upon receiving payment from any payer. The physician shall accept payment from either you or the payer as payment in full for covered services provided to subscribers of a benefits plan that is eligible for covered services. You and the physician agree that neither members nor any payer shall be liable for any charges in excess of those provided in the payer agreement for covered services. You are not liable to compensate the physician in the event of the payer’s failure to compensate the physician. The physician is entitled to bill and collect from the member or payer, as appropriate.

With regard to risk-based contracts, you will establish risk pools and when costs for covered services are less than budgeted amounts, a portion of the savings shall be distributed to the Participating Physician based on a formula developed by your management or authorized third parties, approved by your board of directors, and set forth in your policies and procedures. Also pursuant to the Member Agreement, you may, with the express authorization of your board of directors, collect a fee of up to two percent per month of the total paid under all payer agreements to a physician during that month. The Member Agreement states that this fee is in consideration of your obligations under the agreement and to allow you to cover ordinary and necessary expenses.

You have entered into a managed care network administrative services agreement with Insurance Company to be a Third Party Administrator. Participating physicians have individually opted into this agreement through their own practices and have agreed to accept the payment rates set forth in the agreement for services rendered to Insurance Company's beneficiaries. Also pursuant to this agreement, Hospital has agreed to render services at a percentage discount off its billed charges. The agreement with Insurance Company requires that it a) pay you an administrative fee for accessing your network of providers and b) withhold two percent of each payment due each participating provider and pay this percentage to you monthly.

You have partnered with Partner PHO, an organization that coordinates physician and hospital participation in managed care contracting and arranging for the provision of quality, cost-effective health care services. Your announcement states that Partner PHO offers multiple products to help employers control their health plan expenses, such as network access, medical management, pharmacy management, and data management.

In addition to your primary activities described above, you also hold meetings monthly to discuss opportunities in which Hospital and Participating Physician practices, whether collaboratively or individually, can improve the care they render to the community. You meet, discuss and develop guidelines that may be procedurally implemented in order to improve the quality of care rendered through Hospital and physician practices in the community. You provide a forum for the discussion and recommended implementation of standards that improve the efficiency of services rendered to the community while pursuing conduct that meets strong ethical ideals. You establish patient guidance materials to educate the public concerning healthy lifestyle choices, preventive medicine and general guidance on medical conditions. You seek to provide a central forum and communication vehicle for the discussion of current quality health care practices and techniques, and for recommended implementation of practice management techniques that benefit providers and patients alike.

### *Governance*

Hospital is your sole member, reserving certain powers such as the sole power to approve and amend your Articles of Incorporation and Bylaws and to liquidate or abandon your organization.

Your Bylaws provide that your board of directors will have three different classes. Class A consists of three primary care physicians, preferably from different primary care disciplines. Class B consists of three specialist physicians, one of whom must be a Hospital-based physician, and no two specialist physicians may be from the same specialty discipline. Finally,

Class C reserves three positions for Hospital, one for its CEO and two for other representatives that it appoints. Limits of two three-year terms are placed on members in Classes A and B, while no term limits apply to Class C members.

Your Bylaws also provide for officer positions of chairman, vice chairman, secretary, and treasurer. All officers must be board members who are eligible physician providers with current participation agreements, unless they are Class C members. Currently, your Chairman and Treasurer are physicians and your Secretary is the President and CEO of Hospital.

Your Executive Director and Clerk are also Hospital's employees. You reimburse half of their compensation to Hospital.

#### *Financial Information*

Your income is derived primarily from membership fees, along with a significant amount of gross receipts from services performed. You have not determined a fixed percentage of your net income, or an annual contribution, to distribute to Hospital. You state, however, that your board of directors is cognizant of the fact that all excess funds are for the benefit of Hospital.

You state that you do not have sufficient capital or assets to invest and that you do not make grants.

#### ISSUE 1: WHETHER YOU QUALIFY AS AN ORGANIZATION DESCRIBED IN SECTION 501(C)(3) OF THE INTERNAL REVENUE CODE

##### Law

Section 501(c)(3) of the Code describes a corporation organized and operated exclusively for charitable, educational, and other purposes, provided that no part of its net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (the "regulations") states that to be described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations states that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of the organization to one or more exempt purposes and do not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities which are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iii) of the regulations states that an organization is not organized exclusively for one or more exempt purposes if its articles of organization expressly empower it to carry on, as more than an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(1)(iv) of the regulations states that no organization will be considered to be organized exclusively for one or more exempt purposes if, under its articles of organization, its purposes are broader than the purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be regarded as exempt if more than an insubstantial part of its activities further a non-exempt purpose.

Section 1.501(c)(3)-1(d)(1) of the regulations provides that an organization may be recognized as exempt under section 501(c)(3) of the Code if it is operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirements of this subsection, an organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations includes in the definition of educational activities the instruction or training of the individual for the purpose of improving or developing his capabilities and the instruction of the public on subjects useful to the individual and beneficial to the community.

Rev. Rul. 69-545, 1969-2 C.B. 117, recognizing that the promotion of health is considered to be a charitable purpose in the general law of charity (citing Restatement (Second), Trusts, sec. 368 and sec. 372; Scott on Trusts (3<sup>rd</sup> ed. 1967), sec. 368 and sec. 372), holds that a non-profit hospital that benefits a broad cross section of its community by having an open medical staff and board of trustees broadly representative of the community, operating a full-time emergency room open to all regardless of ability to pay, and otherwise admitting all patients able to pay may qualify as an organization described in section 501(c)(3) of the Code.

Rev. Rul. 86-98, 1986-2 C.B. 74, holds that an individual practice association (IPA) that provides health services through written agreements with health maintenance organizations (HMOs) does not qualify for exemption from federal income tax as a social welfare organization under section 501(c)(4) of the Code. The IPA's stated purpose is to arrange for the delivery of health services through written agreements negotiated with HMOs. Membership in the IPA is limited to practicing licensed physicians who are members of a specified county medical society. The IPA's members generally maintain a private medical practice in addition to performing services for the IPA. The IPA's members are required to enter into written service contracts under which they provide services to the HMO's patients in accordance with a negotiated compensation arrangement between the HMO and IPA. The IPA's primary activities are to serve as a "bargaining agent" for its members in dealing with HMOs and to perform the administrative claims services required by the agreements. Members agree to reimbursement by the IPA according to a fee schedule established by the IPA's board of directors. The ruling



finds that the IPA is “akin to a billing and collection service, and a collective bargaining representative negotiating on behalf of its member-physicians with HMOs.” In addition, the IPA does not provide medical services that would not have been available but for its establishment, or that are available at fees below what is customarily and reasonably charged by the members in their private practices. The IPA is held to operate in a manner similar to a for-profit entity, and its primary beneficiaries are its member-physicians, rather than the community as a whole.

In Geisinger Health Plan v. Commissioner, 985 F.2d 1210 (3rd Cir. 1993), the court held that a pre-paid health care organization that arranges for the provision of health care services, only for its members, benefits its members and not the community as a whole. Under the community benefit standard, the organization must benefit the community as a whole to be recognized as promoting health in the charitable sense of 501(c)(3).

### Analysis

As explained in section 1.501(c)(3)-1(a) of the regulations, to qualify for exemption as an organization described in section 501(c)(3) of the Code, you must be both organized and operated exclusively for one or more of the purposes specified in that section.

### *Organizational Test*

An organization is “organized exclusively” for one or more exempt purposes only if its articles of organization limit the purposes of the organization to one or more exempt purposes and do not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities which are not in furtherance of one or more exempt purposes. See Section 1.501(c)(3)-1(b)(1)(i) of the regulations. Correspondingly, an organization is not organized exclusively for one or more exempt purposes if its articles of organization expressly empower it to carry on, as more than an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes. See Section 1.501(c)(3)-1(b)(1)(iii) of the regulations. In addition, no organization will be considered to be organized exclusively for one or more exempt purposes if, under its articles of organization, its purposes are broader than the purposes specified in section 501(c)(3). See Section 1.501(c)(3)-1(b)(1)(iv) of the regulations.

According to your articles of incorporation, you are organized for the purpose of “transacting any and all lawful business for which non-profit corporations may be organized under the laws of [State] and for which corporations may be engaged....” Although the articles enumerate several specific purposes, those enumerated purposes serve merely as examples of, not as limitations to, the broad general purpose for which you were organized. Thus your purposes are not limited to exempt purposes, but are broader than the purposes specified in section 501(c)(3) of the Code. For even among the enumerated specific purposes are some that empower you to carry on activities that are broader than those permitted under section 501(c)(3). For example, “establishing or participating in one or more health care delivery networks,” “enhancing the delivery of care to the general public through the exchange of ideas,” and “encouraging efficiency and promoting high ethical standards” are not *per se* charitable activities. Accordingly, we find that you are not organized exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(b) of the regulations.



### *Operational Test*

An organization is “operated exclusively” for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3) of the Code, and if not more than an insubstantial part of its activities furthers a non-exempt purpose. See section 1.501(c)(3)-1(c)(1) of the regulations. See also Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945) (when construing a similar provision of the Social Security Act, “[t]he presence of a single [non-exempt] purpose, ... substantial in nature, will destroy the exemption”). Exempt purposes include, among others, charitable and educational purposes. See section 1.501(c)(3)-1(d)(1) of the regulations.

The promotion of health has long been recognized as a charitable purpose under common law. See Rev. Rul. 69-545. However, not every activity that generally promotes health furthers charitable purposes under section 501(c)(3) of the Code. A hospital does not primarily further a charitable purpose solely by offering health care services to the public in exchange for a fee. See Rev. Rul. 69-545, supra. Rather, a hospital must be organized and operated primarily for the benefit of the community, as evidenced by such factors as a board that is representative of the community, operation of an emergency room, provision of charity care, medical training, or medical research. Similarly, the determination of whether a health maintenance organization qualifies for exemption under section 501(c)(3) must be based on whether it benefits the community in addition to its members. In Geisinger Health Plan, 985 F.2d at 1220, the Court, noting that the appellee HMO does not provide any health care services itself, nor does it ensure that people who are not subscribers have access to health care or information about health care, determined that the HMO does not qualify for tax-exempt status under section 501(c)(3) “since it does no more than arrange for its subscribers ... to receive health care services from health care providers.... Arranging for the provision of medical services only to those who “belong” is not necessarily charitable....”

Your primary activity is to enter into Payor Agreements with purchasers of physician medical services on behalf of physicians with whom you have entered into “Member Agreements.” You use a “messenger model” whereby you “act as a vehicle for communicating fee schedule offers to [Participating Physicians] and [Participating Physician’s] counteroffers to insurers.” Thus, like the HMO described in Geisinger Health Plan, you do not provide health care services directly but merely facilitate negotiations between physicians on the medical staff of Hospital to provide physician medical services to consumers of those services. And, as the court held in Geisinger Health Plan, we find that your primary activity – arranging for the provision of medical services only to those with whom you stand in a contractual relationship – is not “charitable” within the meaning of section 501(c)(3) of the Code.

In addition, we find that you are similar to the individual practice association (IPA) described in Rev. Rul. 86-98, except that you have Hospital as a corporate member, and your physician “membership” is limited to physicians who are on the medical staff of hospital or who are Hospital-based physicians. As with the IPA, your Participating Physicians generally maintain their own private medical practices while entering into service agreements with you to provide professional services to payers of health care services in accordance with compensation arrangements negotiated between you and the payers. Like the IPA, you negotiate agreements with payers to pay you or the Participating Physicians for services and you pay the Participating Physicians upon receiving payment from any payer.

In Rev. Rul. 86-98, we found that the IPA described therein did not provide patients access to medical care that would not otherwise be provided, but, instead, was “akin to a billing and collection service, and a collective bargaining representative negotiating on behalf of its member-physicians with HMOs.” Consequently, we held that the IPA did not qualify for exemption under section 501(c)(4) of the Code because it did not operate exclusively for the promotion of social welfare, but “in a manner similar to organizations carried on for profit” for the primary benefit of its member physicians rather than the community as a whole.

Similarly, we hold that you do not qualify for exemption under section 501(c)(3) of the Code because you do not operate exclusively in a charitable manner primarily for the benefit of the community, but, instead, through your primary activities of negotiating Payor Agreements and entering into Member Agreements, serve private interests within the meaning of section 1.501(c)(3)-1(d)(1)(ii) by operating primarily for the benefit of your Participating Physicians. Indeed, your managed care network administrative services agreement with Insurance Company and your affiliation with Partner PHO are further evidence that you simply serve the private interests of your Participating Physicians. For although you engage in an insubstantial amount of activities that could possibly be categorized as “educational,” we find that such activities are primarily for the purpose of providing guidance to Participating Physicians and, thus, provide an additional private benefit to those physicians.

### Conclusion

Because you do not meet the organizational test of section 1.501(c)(3)-1(b) of the regulations or the operational test of section 1.501(c)(3)-1(c), and because you are not organized and operated exclusively for a purpose described in section 1.501(c)(3)-1(d)(1)(i), but, rather, are organized and operated for the benefit of private interests within the meaning of section 1.501(c)(3)-1(d)(1)(ii), you are not exempt as an organization described in section 501(c)(3) of the Code.

## ISSUE 2: WHETHER YOU QUALIFY AS A SUPPORTING ORGANIZATION DESCRIBED IN SECTION 509(A)(3) OF THE CODE

### Law

Section 509(a)(3) of the Code describes as a public charity an organization which:

- (A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in sections 509(a)(1) or 509(a)(2),
- (B) is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or (2), and
- (C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in section 509(a)(1) or (2).

Section 1.509(a)-4(b)(1) of the regulations provides that, in order to qualify as a supporting organization under section 509(a)(3) of the Code, an organization must be both organized and operated exclusively “for the benefit of, to perform the functions of, or to carry out the purposes of” one or more specified publicly supported organizations. If an organization fails to meet either the organization or the operational test, it cannot qualify as a supporting organization.

Section 1.509(a)-4(c)(1)(iii) of the regulations provides that an organization is organized exclusively for one or more purposes specified in section 509(a)(3)(A) of the Code only if its articles of organization: (i) limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A); (ii) do not expressly empower the organization to engage in activities that are not in furtherance of such purposes; (iii) state the specified publicly supported organizations; and (iv) do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations stated in its articles of organization.

Section 1.509(a)-4(d) of the regulations provides that, in order to meet the requirements of section 509(a)(3)(A), an organization must be organized and operated exclusively to support or benefit one or more “specified” publicly supported organizations. With certain exceptions not relevant in this instance, the articles of the organization must designate each of the “specified” organizations by name.

Section 1.509(a)-4(e)(1) of the regulations provides that a supporting organization will be regarded as “operated exclusively” to support one or more specified publicly supported organizations only if it engages solely in activities which support or benefit the specified publicly supported organizations. However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

Section 1.509(a)-4(f)(1) of the regulations provides that, to meet the requirements of section 509(a)(3), an organization must be operated supervised, or controlled by or in connection with one or more publicly supported organizations. If an organization does not stand in one of such relationships to one or more publicly supported organizations, it is not an organization described in section 509(a)(3).

To meet the requirement of section 1.509(a)-4(f)(1), section 1.509(a)-4(f)(2) of the regulations provides that one or more of the three different types of relationships set forth in section 509(a)(3)(B) must be met. Thus, a supporting organization may be: (i) operated, supervised, or controlled by; (ii) supervised or controlled in connection with; or (iii) operated in connection with, one or more publicly supported organizations.

Section 1.509(a)-4(f)(3) of the regulations provides that any relationship described in section 509(a)(3)(B) must insure that (i) the supporting organization will be responsive to the needs and demands of one or more publicly supported organizations; and (ii) the supporting organization will constitute an integral part of, or maintain significant involvement in, the operation of one or more publicly supported organizations.

Section 1.509(a)-4(f)(4) of the regulations provides that, in the case of a supporting organization which is “operated in connection with” one or more publicly supported organizations, the

distinguishing feature is that the supporting organization is responsive to, and significantly involved in the operation of, the publicly supported organization, as described in section 1.509(a)-4(i).

Section 1.509(a)-4(i)(1) of the proposed regulations provides that a supporting organization is operated in connection with one or more supported organizations only if it satisfies: (i) the notification requirement in paragraph (i)(2); (ii) the responsiveness test set forth in paragraph (i)(3); and (iii) the integral part test set forth in paragraphs (i)(4) and (i)(5).

Under the notification requirement of section 1.509(a)-4(i)(2) of the proposed regulations, a supporting organization is required to provide to each of its supported organizations, for each taxable year, (i) a written notice addressed to a principle officer of the supported organization indicating the type and amount of support provided by the supporting organization to the supported organization in the past year; (ii) a copy of the supporting organization's most recently filed Form 990 or other return required to be filed under section 6033; and (iii) a copy of the supporting organization's governing documents, including its charter or trust instrument and bylaws, and any amendments to such documents, unless such documents have previously been provided and have not subsequently been amended.

Section 1.509(a)-4(i)(3) of the proposed regulations provides that an organization meets the responsiveness test if it is responsive to the needs or demands of a publicly supported organization. A supporting organization is responsive to the needs or demands of a supported organization if it satisfies the requirements of paragraphs (i)(3)(ii) and (i)(3)(iii).

A supporting organization satisfies the requirement of section 1.509(a)-4(i)(3)(ii) of the proposed regulations if:

- (A) One or more officers, directors, or trustees of the supporting organization are elected or appointed by the officers, directors, trustees, or membership of the publicly supported organization;
- (B) One or more members of the governing bodies of the publicly supported organization are also officers, directors, or trustees of, or hold other important offices in, the supporting organization; or
- (C) The officers, directors, or trustees of the supporting organization maintain a close and continuous working relationship with the officers, directors, or trustees of the publicly supported organization.

A supporting organization satisfies the requirement of section 1.509(a)-4(i)(3)(iii) of the proposed regulations if, by reason of paragraphs (i)(3)(ii)(A), (i)(3)(ii)(B), or (i)(3)(ii)(C), the officers, directors or trustees of the supported organization have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making them, and the selection of recipients by such supporting organization, and in otherwise directing the use of the income or assets of such supporting organization.

Section 1.509(a)-4(i)(4) of the proposed regulations provides that a supporting organization meets the integral part test as a functionally integrated Type III supporting organization if it satisfies either paragraph (i)(4)(i)(A) or paragraph (i)(4)(i)(B) of this section. A supporting organization meets the integral part test under paragraph (i)(4)(i)(A) if it engages in activities:

(1) Substantially all of which directly further the exempt purposes of the supported organization(s) to which the supporting organization is responsive, by performing the functions of, or carrying out the purposes of, such supported organization(s); and

(2) That, but for the involvement of the supporting organization, would normally be engaged in by the supported organization.

A supporting organization meets the integral part test under paragraph (i)(4)(i)(B) if it is the parent of each of its supported organizations.

Section 1.509(a)-4(i)(5) of the proposed regulations provides that a supporting organization meets the integral part test as a non-functionally integrated Type III supporting organization if it distributes, with respect to each taxable year, to or for the use of one or more supported organizations, amounts equaling or exceeding the supporting organization's annual distributable amount for such year, as defined in paragraph (i)(5)(ii)(B) of this section, on or before the last day of such taxable year.

### Analysis

Section 509(a)(3)(A) describes as a public charity, an organization which is organized and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2). Additionally, the organization described in section 509(a)(3) is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or (2). You state that you meet the requirements for section 509(a)(3) as an organization that is "operated in connection with" an organization that is described in sections 509(a)(1) or 509(a)(2). Specifically, you claim to be "operated in connection with" Hospital.

To be considered a supporting organization within the meaning of section 509(a)(3) of the Code, you must meet the organizational test under section 1.509(a)-4(c) of the regulations, "specify" (within the meaning of section 1.509(a)-4(d)) the publicly supported organization for whose support or benefit you are exclusively organized and operated, meet the operational test under section 1.509(a)-4(e), and the relationship test under section 1.509(a)-4(f). To meet the relationship test, you must stand in one or more of the relationships described in sections 1.509(a)-4(g) through (i) with respect to Hospital. You have failed to establish that you meet the requirements of section 509(a)(3) for the following reasons.

### *Organizational Test*

To meet the organizational test under section 1.509(a)-4(c) of the regulations your articles of organization must (i) limit your purposes to those described in section 509(a)(3)(A), (that is, to those purposes that are exclusively for the benefit of, that perform the functions of, or that carry out the purposes of, one or more organizations described in section 509(a)(1) or (2)); (ii) not expressly empower you to engage in activities which are not in furtherance of such purposes; and (iii) state the specified publicly supported organizations on whose behalf you are to be operated.

Your Articles of Incorporation do not limit your purposes to those that benefit, perform the functions of, or carry out the purposes of, Hospital. Rather, your Articles empower you to



“transact any and all lawful business for which non-profit corporations may be organized under the laws of [State] and for which corporations may be engaged ....” Furthermore, your articles do not specifically state that you are operated on behalf of Hospital. Under section 1.509(a)-4(d) of the regulations, an organization that is “operated in connection with” one or more “specified” publicly supported organizations, as you claim to be, must designate in its articles each of the specified organizations by name. Although your Articles list Hospital as your sole member, they do not designate Hospital as the organization you are organized and operated exclusively to support or benefit. Therefore, you do not meet the organizational test under section 1.509(a)-4(c).

### *Operational Test*

To meet the operational test of section 1.509(a)-4(e) of the regulations, you must engage solely in activities that support or benefit “specified” publicly supported organizations. As mentioned above, your Articles do not designate Hospital as the specified publicly supported organization on whose behalf you operate. But even if they did, you do not engage solely in activities that support or benefit Hospital. For example, your contracting with insurance companies on behalf of your membership, and your plan to assist local employers in controlling their health plan expenses, are not for the benefit of Hospital. Rather, your activities are primarily for the support and benefit of your Participating Physicians in their private medical practices. Therefore, you do not meet the operational test of section 1.509(a)-4(e).

### *Relationship Test*

To meet the relationship test, you must stand in one or more of the relationships described in sections 1.509(a)-4(g) through (i) of the regulations with respect to Hospital. You claim to be “operated in connection with” Hospital within the meaning of section 1.509(a)-4(i). You would be considered as being “operated in connection with” Hospital only if you met the notification requirement set forth in section 1.509(a)-4(i)(2) of the proposed regulations, the responsiveness test set forth in section 1.509(a)-4(i)(3) of the proposed regulations, and the integral part test set forth in section 1.509(a)-4(i)(4) or (5) of the proposed regulations.

To meet the notification requirement of section 1.509(a)-4(i)(2) of the proposed regulations, you must provide Hospital, for each taxable year, (i) a written notice addressed to the Hospital’s principal officer indicating the type and amount of support you provided Hospital in the past year; (ii) a copy of your most recently filed Form 990; and (iii) a copy of your governing documents. You have not demonstrated, in either your application or subsequent correspondence, that you meet this requirement.

### *Responsiveness Test*

You would meet the responsive test under section 1.509(a)-4(i)(3) of the proposed regulations if one or more of your officers or directors is elected or appointed by the officers or directors of Hospital and, as a result, the officers, directors, or trustees of Hospital have a significant voice in your investment policies and in directing the use of your income or assets.

Under the provisions of your Bylaws, your Board is divided into three Classes, each of which has three members. One of those Classes, Class C, consists of members that represent



Hospital: one member is the individual then serving as Hospital's CEO and the other two members are individuals appointed by Hospital. Unlike members in Classes A and B, Class C members are not subject to term limits.

Your Bylaws provide that for all matters, other than approving fee schedules and charges, only a simple majority of the total number of Board members (irrespective of classes) will constitute a quorum. Pursuant to this provision, you do not require that members from Class C, who represent Hospital, have a significant voice in your investment policies or in directing the use of your income or assets. Consequently, you do not meet the responsiveness test under section 1.509(a)-4(i)(3) of the proposed regulations.

#### *Integral Part Test*

To meet the integral part test, you must qualify either as a "functionally integrated Type III" supporting organization under section 1.509(a)-4(i)(4) of the proposed regulations or as a "non-functionally integrated Type III" supporting organization under section 1.509(a)-4(i)(5). Non-functionally integrated Type III supporting organizations are grant making organizations. Because you do not make grants, you would not meet the integral part test under section 1.509(a)-4(i)(5). Further, you would not meet the integral part test as a functionally integrated Type III supporting organization under section 1.509(a)-4(i)(4) unless either: (i) the activities you engage in for, or on behalf of, Hospital are activities to perform the functions of, or to carry out the purposes of, Hospital and that, but for your involvement, would normally be engaged in by Hospital, or (ii) you must be the parent of Hospital. You are not the parent of Hospital. Neither do you engage in activities to perform the functions of, or carry out the purposes of, Hospital. You have stated that you do not carry out Hospital's purposes, but rather carry out your own. Additionally, you have stated that Hospital did not conduct your activities prior to your creation, and that but for your involvement, Hospital would not normally conduct the activities that you conduct. Thus, you fail to meet the integral part test as a functionally integrated Type III supporting organization under section 1.509(a)-4(i)(4). Because you do not meet either branch of the integral part test, we also conclude that you are not "operated in connection with" Hospital within the meaning of section 1.509(a)-4(i) of the proposed regulations and, hence, do not meet the relationship test under section 1.509(a)-4(f) of the regulations.

#### Conclusion

Because you do not meet the organizational test under section 1.509(a)-4(c) of the regulations, the operational test under section 1.509(a)-4(e), or the relationship test under section 1.509(a)-4(f), we rule that you do not qualify as a supporting organization described in section 509(a)(3) of the Code.

For the reasons set forth above, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

*Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service  
TE/GE (SE:T:EO:RA:T:1)

1111 Constitution Ave, N.W.  
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Sean M. Barnett for

Lois G. Lerner  
Director, Exempt Organizations